

Internal Revenue Service

Number: **202144007**

Release Date: 11/5/2021

Index Number: 141.00-00, 141.01-02

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:5

PLR-103012-21

Date:

August 10, 2021

LEGEND

Agency =

Bonds =

State =

City =

Year 1 =

State's Department =

Date 1 =

Year 2 =

Date 2 =

x =

y =

Date 3 =

z =

Dear _____ :

This is in response to the request on behalf of the Agency for a ruling that the Bonds will not meet the private security or payment test under § 141(b)(2) of the Internal Revenue Code.

Facts and Representations

You make the following factual representations. The Agency is a supplier of water in the State and provides water in an area covering the boundaries of the City and many of its suburbs.

Under the State's drinking water regulations, the Agency must sample the water in its system to determine whether the concentrations of lead exceed certain levels (the "lead action level"), which would trigger actions including corrosion control treatment and public education. The water delivered by the Agency does not contain lead, nor do any facilities or distribution lines owned by the Agency. However, the corrosive quality of water can cause lead from service lines, that is, the pipes from the Agency's distribution line in the street to the residence or other building being served, to leach into the water supply, causing a health risk. The service lines are owned by the owner of the property being served. The only way to eliminate this health risk completely is to remove the lead service line ("LSL") and replace it with a copper service line.

In Year 1, the Agency's water sampling results showed an exceedance of the lead action level. The Agency conducted tests and recommended a treatment method, which was rejected by the State's Department, which ordered the Agency to implement a different treatment method on or before Date 1. The Agency applied to the United States Environmental Protection Agency ("EPA") for a variance to implement a lead reduction program plan ("LRPP") in lieu of the treatment method ordered by the State's Department. On Date 2, the EPA authorized the Agency to implement the LRPP. This would require replacement of x percent of the LSLs within the Agency's service area each year so that all LSLs are replaced within y years. The replacement of LSLs will achieve additional lead removal benefits that could not otherwise be achieved under the treatment ordered by the State's Department.

The Agency will replace LSLs for both residential and commercial customers. The customers own the existing LSLs and will own the pipes replacing the LSL ("LSL Replacements"). A portion of the LSL Replacements could be for residential customers who treat their home as a rental property or for residential customers that are running a business out of their home.

Either the Agency will directly pay the costs of replacing the LSL or the Agency's customer receiving an LSL Replacement will pay those costs and the Agency will reimburse the customer for a portion of the costs. The Agency's customers receiving

the LSL Replacements will have no obligation to repay the Agency for any costs relating to the LSL Replacement. The Agency will not impose special charges on those customers who receive an LSL Replacement. Instead, the Agency will use the rates and charges that it imposes on all of its customers to pay for the costs of replacing the LSLs and other aspects of the LRPP, including the debt service on the Bonds (described below).

The Agency can modify its rates at any time, without oversight by the State's public utilities oversight authority or any other State agency. The Agency reviews and updates its financial plan at least annually to ensure revenue is sufficient to meet expenditures.

The Agency issued the Bonds on Date 3 to finance or refinance certain capital improvements to the Agency's water system and the costs of replacing the LSLs. The Agency expects that private business use (as defined in § 141(b)(6)) of the LSL replacements likely will cause the Bonds to satisfy the private business use test of § 141(b)(1). No other assets financed by the Bonds will be used for a private business use.

The Bonds are payable from and secured by the Agency's net revenue, which consists of its gross revenue minus operating and maintenance expenses. The Agency's gross revenue includes all income and revenues from the operation and use of its system. The Agency has determined that z percent, a percentage that does not exceed 10 percent, of the debt service on the Bonds will be derived from payments that are both received from customers that are private business users of LSL Replacements and attributable to the costs of replacing the LSLs.

Law and Analysis

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond.

Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue (1) which meets (A) the private business use test of § 141(b)(1), and (B) the private security or payment test of § 141(b)(2), or (2) which meets the private loan financing test of § 141(c).

Section 141(b)(1) provides that, except as otherwise provided in § 141(b)(1), an issue meets the test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use.

Section 141(b)(2) provides that, except as otherwise provided in § 141(b)(2), an issue meets the private security or payment test if the payment of the principal of, or the

interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-4(a)(1) provides that the private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private business use. The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly, secured by any interest in property used or to be used for a private business use or payments in respect of property used to be used for a private business use.

Section 1.141-4(a)(2) provides that, for purposes of the private security or payment test, payments taken into account as private payments and payments or property taken into account as private security are aggregated. However, the same payments are not taken into account as both private security and private payments.

Section 1.141-4(c)(2)(i)(A) provides that both direct and indirect payments made by any nongovernmental person that is treated as using proceeds of the issue are taken into account as private payments to the extent allocable to the proceeds used by that person. Payments are taken into account as private payments only to the extent that they are made for the period of time that proceeds are used for a private business use. Payments for a use of proceeds include payments (whether or not to the issuer) in respect of property financed (directly or indirectly) with those proceeds, even if not made by a private business user. Payments are not made in respect of financed property if those payments are directly allocable to other property being directly used by the person making the payment and those payments represent fair market value compensation for that other use.

Section 1.141-4(d)(4) provides that property used or to be used for a private business use and payments in respect of that property are treated as private security if any interest in that property or payments secures the payment of debt service on the bonds. For this purpose, the phrase any interest in is to be interpreted broadly and includes, for example, any right, claim, title, or legal share in property or payments.

Section 1.141-4(d)(5) provides that payments taken into account as private security are payments in respect of property used or to be used for a private business use. Except as otherwise provided in § 1.141-4(d)(5) and (d)(6), the rules in § 1.141-4(c)(2)(i)(A) and (B) and (c)(2)(ii) apply to determine the amount of payments treated as payments in respect of property used or to be used for a private business use.

The source of the payments of and security for the debt service on the Bonds is the net revenue of the Agency. The net revenue includes the rates and charges paid by the Agency's customers. The rates and charges imposed on all of the Agency's customers will pay for the costs of replacing the LSLs.

The Agency argues that no payments from its customers should count as private payments or security because those payments are payments solely for water service. However, it is clear that a portion of the customers' payments of rates and charges, which provide the payments of and security for the debt service on the Bonds, is in respect of the LSL Replacements. Thus, we must analyze these payments under the private security or payment test.

The customers served by the Agency include (1) customers that do not receive LSL Replacements, (2) customers that receive LSL Replacements and that are not business users, and (3) customers that receive LSL Replacements and that are private business users. Payments by customers that do not receive LSL Replacements are not private payments or security because, under § 1.141-4(c)(2)(i)(A) and (d)(5), payments are taken into account as private payments or security only to the extent allocable to proceeds used by that payor for a period of time that the proceeds are used for a private business use. These customers are not using LSL Replacements and therefore, not using proceeds of the Bonds that financed the LSL Replacements.

Payments by customers that receive LSL Replacements and that are not business users are not private payments or security. Although these customers are users of LSL Replacements and thus of proceeds, the proceeds used by these customers are not used for a private business use and therefore, are not taken into account as private payments or security.

Payments by customers that receive LSL Replacements and that are private business users are, in part, private payments and security for the Bonds. These customers are users of the proceeds of the Bonds and those proceeds are used in a private business use. Customer payments, however, include amounts attributable to the Agency's delivery of water service as well as amounts attributable to the costs of replacing the LSLs. The amounts received from this group of customers that are attributable to replacing the LSLs are taken into account as private payments or security. The Agency has determined that z percent, a percentage that does not exceed 10 percent, of the debt service on the Bonds will be derived from payments that are both received from customers that are private business users of LSL Replacements and attributable to the costs of replacing the LSLs.

Conclusion

Accordingly, because the payments that are both received from customers that are private business users of LSL Replacements and attributable to the costs of replacing

the LSLs do not exceed 10 percent of the debt service on the Bonds, the Bonds will not meet the private security or payment test.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The ruling contained in this letter is based upon information and representations submitted by the Agency and accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified any of the materials submitted in support of the request for a ruling, they are subject to verification upon examination.

Sincerely,
Associate Chief Counsel
(Financial Institutions and Products)

Johanna Som de Cerff
Senior Technical Reviewer, Branch 5

cc: